

**REPORT OF THE AUDITOR-GENERAL TO THE PROVINCIAL LEGISLATURE  
AND THE COUNCIL ON THE FINANCIAL STATEMENTS AND PERFORMANCE  
INFORMATION OF THE GREATER TZANEEN MUNICIPALITY FOR THE YEAR  
ENDED 30 JUNE 2009**

**REPORT ON THE FINANCIAL STATEMENTS**

**Introduction**

1. I have audited the accompanying financial statements of the Greater Tzaneen Municipality which comprise, the statement of financial position as at 30 June 2009, and the statement of financial performance, the statement of changes in net assets and the cash flow statement for the year then ended, and a summary of significant accounting policies and other explanatory notes as set out on pages [xx] to [xx].

**The accounting officer's responsibility for the financial statements**

2. The accounting officer is responsible for the preparation and fair presentation of these financial statements in accordance with the statements of Generally Recognised Accounting Practice (statements of GRAP) and in the manner required by the Local Government: Municipal Finance Management Act, 2003 (Act No. 56 of 2003) (MFMA), *Auditor-General audit circular 1 of 2007*, and for such internal control as the accounting officer determines is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

**The Auditor-General's responsibility**

3. As required by section 188 of the Constitution of the Republic of South Africa, 1996 read with section 4 of the Public Audit Act, 2004 (Act No. 25 of 2004) (PAA), my responsibility is to express an opinion on these financial statements based on my audit.
4. I conducted my audit in accordance with the International Standards on Auditing read with *General Notice 616 of 2008*, issued in *Government Gazette No. 31057 of 15 May 2008*. Those standards require that I comply with ethical requirements and plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.
5. An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgement, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.
6. Paragraph 11 et seq. of the Statement of Generally Recognised Accounting Practice, GRAP 1, *Presentation of Financial Statements* requires that financial reporting by entities shall provide information on whether resources were obtained and used in accordance with the legally adopted budget. As the budget



reporting standard is not effective for this financial year, I have determined that my audit of any disclosures made by the Greater Tzaneen Municipality in this respect will be limited to reporting on non-compliance with this disclosure requirement.

7. I believe that the audit evidence I have obtained is sufficient and appropriate to provide a basis for my audit opinion.

#### **Basis for qualified opinion**

##### **Accounts payable**

8. The amount for 13<sup>th</sup> cheque bonuses included under accounts payable only reflects the accrual for section 57 managers and heads of divisions. An accrual for all other employees entitled to 13<sup>th</sup> cheque bonuses was not computed and recorded in the financial statements. As a result, I was unable to verify the completeness and valuation of the 13<sup>th</sup> cheque accrual amounting to R1,5 million and the corresponding effect on the accuracy of employee cost.

##### **Financial lease liability**

9. An amortization schedule was available for the financial lease liability balance of R10,9 million disclosed in the financial statements. However, I was unable to obtain the supporting documentation for the amounts used in that schedule. Furthermore, note 3 to the financial statements, representing the finance lease liability, has not been correctly disclosed in terms of GRAP 13 and the amount disclosed in that note did not agree with the finance lease liability balance of R10,9 million by R1,3 million. As a result I could not verify the valuation of the financial lease liability balance and the accuracy of the interest cost on the finance lease.

##### **Property, plant and equipment**

10. Infrastructure assets amounting to R156,2 million were not separately identified and valued in accordance with GRAP 17 in the asset register.
11. Properties amounting to R3,4 million registered in the name of the municipality are not included in the asset register.
12. Assets amounting to R6,2 million were selected from the asset register but could not be physically verified for existence.
13. An amount of R16,6 million was capitalised as the cost price for finance lease assets. However, there was no supporting documentation available to substantiate that amount. Consequently, I could not verify the valuation of the finance lease assets and the accuracy of the depreciation amounting to R3,6 million computed on these assets.
14. An amount of R14,1 million representing impairment of assets has not been accounted for in the statement of financial performance. This amount was directly accounted for in the statement of changes in net assets. This accounting treatment is contrary to the municipality's accounting policy as well as the requirements of GRAP 17.
15. As a result of the matters listed above, I was unable to verify the completeness, existence and valuation of property, plant and equipment balance of R232,9 million.

**Revenue**

16. The breakdown of property rates amounting to R27,7 million, disclosed under note 18 to the financial statements could not be agreed to supporting documentation as the system being used by the municipality could not generate this report. As a result, I was unable to verify the classification of property rates as disclosed in the notes to the financial statements.

**Prior year error**

17. The prior year error, amounting to R12,9 million and R7,6 million, disclosed in the statement of changes in net assets for the 2007-08 and 2008-09 financial years respectively, has not been correctly accounted for in terms of GRAP 3. The error related to finance leases that were not accounted for from the 2006-07 financial period. The error has not been adjusted for retrospectively and the opening balances have not been restated for the earliest period presented in terms of paragraph GRAP 3.42(b), which is the 2007-08 financial year.

**Qualified opinion**

18. In my opinion, except for the effects of the matters described in the Basis for qualified opinion paragraphs, the financial statements present fairly, in all material respects, the financial position of the Greater Tzaneen Municipality as at 30 June 2009 and its financial performance and its cash flows for the year then ended, in accordance with the Generally Recognised Accounting Practice (GRAP) and in the manner required by the MFMA and DoRA.

**Emphasis of matters**

19. Without further qualifying my opinion, I draw attention to the following matters:

**Going concern**

20. As disclosed in note 44 to the financial statements, current liabilities exceeded current assets by R33,6 million for the year ended 30 June 2009. Furthermore, money received from conditional grants has also been utilised to fund operational expenditure. These conditions, along with other matters, point to the existence of a material uncertainty that may cast significant doubt on the entity's ability to continue as a going concern.

**Irregular, fruitless and wasteful expenditure**

21. As disclosed in note 35 to the financial statements, fruitless and wasteful expenditure to the amount of R3,8 million was incurred. The expenditure resulted from the loss of cash due to fraud and the once-off payouts to two employees who were dismissed by the municipality. Furthermore, irregular expenditure amounting to R32,9 million was incurred by the municipality as they used money from conditional grants to fund operational expenditure.

**Restatement of corresponding figures**

22. As disclosed in note 30 to the financial statements, the corresponding figures for year ended 30 June 2008 have been restated as a result of an error discovered during the 2008-09 financial year of the Greater Tzaneen Municipality.

**Other matters**

23. Without further qualifying my opinion, I draw attention to the following matters that relate to my responsibilities in the audit of the financial statements:

### **Unaudited supplementary schedules**

24. The supplementary information set out on pages [xx] to [xx] does not form part of the financial statements and is presented as additional information. I have not audited these schedules and accordingly I do not express an opinion thereon.

### **Non-compliance with application legislation**

25. In terms of paragraph 64(2)(h) of the MFMA the accounting officer must for the purposes of subsection (1) take all reasonable steps to ensure that all revenue received by the municipality, including revenue received by any collecting agent on its behalf, is reconciled at least on a weekly basis. However, it was noted that the property rate reconciliations were not prepared during the year.

26. In terms of paragraph 62(1)(c)(i) of the MFMA the accounting officer of a municipality is responsible for managing the financial administration of the municipality and must, for this purpose, take all reasonable steps to ensure that the municipality has and maintains effective, efficient and transparent systems of financial and risk management and internal control. Such systems and control would include bank reconciliations. However, it was noted that monthly bank reconciliations were not performed.

27. All councilors did not disclose their financial interests as required by the Municipal Systems Act, 2000 (Act No. 32 of 2000) (schedule (1), section (5) – disclosure of interest).

### **Governance framework**

28. The governance principles that impact the auditor's opinion on the financial statements are related to the responsibilities and practices exercised by the accounting officer and executive management and are reflected in the internal control deficiencies and key governance responsibilities addressed below:

### **Internal control deficiencies**

29. Section 62(1)(c)(i) of the MFMA states that the accounting officer must ensure that the municipality has and maintains effective, efficient and transparent systems of financial and risk management and internal control. The table below depicts the root causes that gave rise to the deficiencies in the system of internal control, which led to the qualified opinion. The root causes are categorised according to the five components of an effective system of internal control. In some instances deficiencies exist in more than one internal control component.

Par. no.	Basis for qualified opinion	CE	RA	CA	IC	M
8	Accounts payable	5	2	4		
9	Finance lease liability	5		4	1	
10-15	Property, plant and equipment	5	3	4	1	1
16	Revenue			4	1	
17	Prior period error	5		4		

30. The errors identified during the audit can be attributed to the difficulties experienced by the municipality's financial staff in applying the GRAP standards applicable in terms of the basis of accounting.



<b>Legend</b>	
<b>CE = Control environment</b>	
The organisational structure does not address areas of responsibility and lines of reporting to support effective control over financial reporting.	1
Management and staff are not assigned appropriate levels of authority and responsibility to facilitate control over financial reporting.	2
Human resource policies do not facilitate effective recruitment and training, disciplining and supervision of personnel.	3
Integrity and ethical values have not been developed and are not understood to set the standard for financial reporting.	4
The accounting officer/accounting authority does not exercise oversight responsibility over financial reporting and internal control.	5
Management's philosophy and operating style do not promote effective control over financial reporting.	6
The entity does not have individuals competent in financial reporting and related matters.	7
<b>RA = Risk assessment</b>	
Management has not specified financial reporting objectives to enable the identification of risks to reliable financial reporting.	1
The entity does not identify risks to the achievement of financial reporting objectives.	2
The entity does not analyse the likelihood and impact of the risks identified.	3
The entity does not determine a risk strategy/action plan to manage identified risks.	4
The potential for material misstatement due to fraud is not considered.	5
<b>CA = Control activities</b>	
There is inadequate segregation of duties to prevent fraudulent data and asset misappropriation.	1
General information technology controls have not been designed to maintain the integrity of the information system and the security of the data.	2
Manual or automated controls are not designed to ensure that the transactions have occurred, are authorised, and are completely and accurately processed.	3
Actions are not taken to address risks to the achievement of financial reporting objectives.	4
Control activities are not selected and developed to mitigate risks over financial reporting.	5
Policies and procedures related to financial reporting are not established and communicated.	6
Realistic targets are not set for financial performance measures, which are in turn not linked to an effective reward system.	7
<b>IC = Information and communication</b>	
Pertinent information is not identified and captured in a form and time frame to support financial reporting.	1
Information required to implement internal control is not available to personnel to enable internal control responsibilities.	2
Communications do not enable and support the understanding and execution of internal control processes and responsibilities by personnel.	3
<b>M = Monitoring</b>	
Ongoing monitoring and supervision are not undertaken to enable an assessment of the effectiveness of internal control over financial reporting.	1
Neither reviews by internal audit or the audit committee nor self-assessments are evident.	2
Internal control deficiencies are not identified and communicated in a timely manner to allow for corrective action to be taken.	3

### Key governance responsibilities

31. The MFMA tasks the accounting officer with a number of responsibilities concerning financial and risk management and internal control. Fundamental to achieving this is the implementation of key governance responsibilities, which I have assessed as follows:

No.	Matter	Y	N
<b>Clear trail of supporting documentation that is easily available and provided in a timely manner</b>			
1.	No significant difficulties were experienced during the audit concerning delays or the availability of requested information.	✓	
<b>Quality of financial statements and related management information</b>			
2.	The financial statements were not subject to any material amendments resulting from the audit.	✓	
3.	The annual report was submitted for consideration prior to the tabling of the auditor's report.	✓	
<b>Timeliness of financial statements and management information</b>			

No.	Matter	Y	N
4.	The annual financial statements were submitted for auditing as per the legislated deadlines (section 126 of the MFMA).	✓	
	<b>Availability of key officials during audit</b>		
5.	Key officials were available throughout the audit process.	✓	
	<b>Development and compliance with risk management, effective internal control and governance practices</b>		
6.	Audit committee		
	• The municipality had an audit committee in operation throughout the financial year.	✓	
	• The audit committee operates in accordance with approved, written terms of reference.	✓	
	• The audit committee substantially fulfilled its responsibilities for the year, as set out in section 166(2) of the MFMA.	✓	
7.	Internal audit		
	• The municipality had an internal audit function in operation throughout the financial year.	✓	
	• The internal audit function operates in terms of an approved internal audit plan.	✓	
	• The internal audit function substantially fulfilled its responsibilities for the year, as set out in section 165(2) of the MFMA.	✓	
8.	There are no significant deficiencies in the design and implementation of internal control in respect of financial and risk management.	✓	
9.	There are no significant deficiencies in the design and implementation of internal control in respect of compliance with applicable laws and regulations.	✓	
10.	The information systems were appropriate to facilitate the preparation of the financial statements.	✓	
11.	A risk assessment was conducted on a regular basis and a risk management strategy, which includes a fraud prevention plan, is documented and used as set out in section 62(c)(i) of the MFMA.	✓	
12.	Delegations of responsibility are in place, as set out in section 79 of the MFMA.	✓	
	<b>Follow-up of audit findings</b>		
13.	The prior year audit findings have been substantially addressed.	✓	
	<b>Issues relating to the reporting of performance information</b>		
14.	The information systems were appropriate to facilitate the preparation of a performance report that is accurate and complete.	✓	
15.	Adequate control processes and procedures are designed and implemented to ensure the accuracy and completeness of reported performance information.	✓	
16.	A strategic plan was prepared and approved for the financial year under review for purposes of monitoring the performance in relation to the budget and delivery by the municipality against its mandate, predetermined objectives, outputs, indicators and targets (section 68 of the MFMA).	✓	
17.	There is a functioning performance management system and performance bonuses are only paid after proper assessment and approval by those charged with governance.	✓	

32. Overall reflection on key governance responsibilities:

- The financial statements were adjusted for the exceptions identified during the audit. The exceptions resulted from a lack of understanding of the applicable GRAP standards.
- Key officials were not available during the finalisation of the audit process as they were attending training or were on leave.
- Internal audit did not perform all the audits per their internal audit plan as they did not have enough staff members.
- Deficiencies were identified in the internal control system in respect of financial and risk management, which allowed the misappropriation of cash (as discussed in paragraph 32 below) not being detected timeously. One of the key controls not in place during the year was the performance of regular



bank reconciliations. The position for head of division in the revenue section was vacant. The office of the CFO did not intervene timeously to ensure that the bank reconciliations are prepared regularly.

- Appropriate actions were not taken to ensure compliance with all applicable laws and regulations.
- A fraud prevention plan was drafted but was not approved and implemented during the financial year.
- The accounting officer did not develop proper information systems to facilitate the preparation of performance information that is accurate and complete.

### **Investigations**

33. A forensic investigation was conducted by an independent consulting firm on request of the municipality. The investigation was initiated based on allegations of possible misappropriation of cash amounting to R914 682 by employees of the municipality. The investigation has resulted in criminal proceedings being instituted against a former employee.

## **REPORT ON OTHER LEGAL AND REGULATORY REQUIREMENTS**

### **Reporting on performance information**

34. I was engaged to review the performance information.

### **The accounting officer's responsibility for the performance information**

35. In terms of section 121(3)(c) of the Municipal Finance Management Act, the annual report of a municipality must include the annual performance report of the municipality, prepared by the municipality in terms of section 46 of the Local Government: Municipal Systems Act, 2000 (Act No. 32 of 2000) (MSA).

### **The Auditor-General's responsibility**

36. I conducted my engagement in accordance with section 13 of the Public Audit Act, 2004 (Act No. 25 of 2004) read with *General Notice 616 of 2008*, issued in *Government Gazette No. 31057 of 15 May 2008* and section 45 of the MSA.

37. In terms of the foregoing my engagement included performing procedures of an audit nature to obtain sufficient appropriate audit evidence about the performance information and related systems, processes and procedures. The procedures selected depend on the auditor's judgement.

38. I believe that the evidence I have obtained is sufficient and appropriate to provide a basis for the audit findings reported below.

### **Audit findings**

#### **Non-compliance with regulatory requirements**

39. The municipality did not adopt a performance management system as required by section 8 of the Local Government: Municipal Planning and Performance Management Regulations, 2001 (Gazette number (GRN) 796 of 24 August 2001).

40. The municipality did not develop and implement mechanisms, systems and processes for auditing the results of performance measurement as part of its internal audit processes, as required in terms of section 45(a) of the MSA and

section 14(c) of the Local Government: Municipal Planning and Performance Management Regulations, 2001 (GNR 796 of 24 August 2001).

41. No evidence was provided that the performance audit committee reviewed all the quarterly performance reports for the year under review. An audit report was also not submitted to the council regarding the performance management system of the municipality, as required by section 14(4)(a) of the Local Government: Municipal Planning and Performance Management Regulations, 2001 (GNR 796 of 24 August 2001).

**Performance information not received in time**

42. The municipality did not provide me with the annual performance report in terms of section 46 of the MFMA as it was not yet finalised and approved at the time of the audit.

**APPRECIATION**

43. The assistance rendered by the staff of the Greater Tzaneen Municipality during the audit is sincerely appreciated.

*Auditor - General,*

Pretoria

30 November 2009



Auditing to build public confidence